IN THE

Supreme Court of the United States

October Term, 1978
No. 78-646

SOUTHERN CALIFORNIA EDISON COMPANY,

Appellant,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ROBERT BATINOVICH, WILLIAM SYMONS, JR., VERNON L. STURGEON, LEONARD ROSS, and RICHARD D. GRAVELLE, the members of and constituting said Public Utilities Commission,

Appellees.

SOUTHERN CALIFORNIA EDISON COMPANY,

Appellant,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ROBERT BATINOVICH, WILLIAM SYMONS, JR., VERNON L. STURGEON, CLAIRE T. DEDRICK, and RICHARD D. GRAVELLE, the members of and constituting said Public Utilities Commission,

Appellees.

On Appeal From the Supreme Court of the State of California.

Appellant's Reply Brief in Opposition to Motion to Dismiss or Affirm.

JOHN R. BURY,
WILLIAM E. MARX,
ROLLIN E. WOODBURY,
2244 Walnut Grove Avenue,
P.O. Box 800,
Rosemead, Calif. 91770,
(213) 572-2289,
Attorneys for Appellant
Southern California Edison Company.

Parker & Son, Inc., Law Printers, Los Angeles. Phone 724-6622

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On Appeal From the Supreme Court of the State of California.

Appellant's Reply Brief in Opposition to Motion to Dismiss or Affirm.

Appellant herewith files its Reply Brief to point out substantive errors in the Motion to Dismiss or Affirm (hereinafter referred to as "Motion") filed on behalf of the Appellees which render such Motion defective and without merit.

A. Refutation of Argument in Motion Relating to the First Question Presented in the Jurisdictional Statement.[1]

1. Appellees assert, at page 4 of the Motion, that an interpretation of the Commission's decision (that the Commission was construing this Court's decisions as precluding the Commission from setting an allowed rate of return at a level higher than the minimum required to avoid confiscation) cannot be read into the Decision (Decision No. 86794). In refutation, Appellant points out that the Commission stated in said Decision (Appendix p. 5) that the United States Supreme Court "has broadly *defined the revenue requirements* of utility companies *as being the minimum* amount" (emphasis added) which will enable the Company to meet the *Hope* and *Bluefield* tests.[2] Defining "the revenue requirements" as being "the minimum amount" indicates that authorized revenue requirements cannot be something more and constitutes more than "merely reciting" the constitutional requirements of those decisions. Furthermore, this issue was duly raised in Edison's petition for rehearing

[1]Question "1. Do decisions of the United States Supreme Court, including *Federal Power Commission v. Hope Natural Gas Company,* 320 U.S. 591 (1944), and *Bluefield Waterworks & Improvement Company v. West Virginia Public Service Commission,* 262 U.S. 679 (1923), which were relied upon by the Commission, *preclude* a state regulatory commission from setting an allowed rate of return at a level higher than the minimum required to avoid confiscation?" (See p. 5 of Jurisdictional Statement and pp. 2 and 3 of Motion.)

[2]Citing: *Federal Power Commission v. Hope Natural Gas Company* (1944) 320 U.S. 591, 605, 88 L.ed. 333, 346; *Bluefield Waterworks and Improvement Co. v. West Virginia P.S.C.* (1923) 262 U.S. 679, 692, 693; 67 L.ed. at 1176.

before the Commission dated January 7, 1977 (Appendix p. 149) and the Commission neither granted rehearing on the issue, nor corrected, nor clarified its decision, nor denied that it had felt itself legally required to fix utility rates at such minimum nor denied that it had applied such improper standard.

2. Although elsewhere (Motion p. 8), Appellees assert that the rate of return adopted by the Commission for Edison, was near the high end of a range recommended by a Commission staff witness,[3] they nowhere deny (nor could they because it is indisputable) that the Commission authorized only what it determined to be "the minimum needed" by the Company (see Juris. Statement, p. 4; Dec. No. 86794, p. 23; Appendix p. 21).
3. Appellees assert (Motion p. 6) that "the Commission considered a host of relevant factors, as it always does when, in a general rate case, it adopts a rate of return for a new test year." Consideration of a host of factors, no matter how multitudinous, obviously does not cure the application of an improper legal standard to those factors.

[3]Notwithstanding the testimony of expert witnesses appearing on behalf of other participants in the proceeding supporting much higher rates of return.

B. Refutation of Argument in Motion Relating to the Second Separate Question Presented in the Jurisdictional Statement.[4]

1. It is indisputable that in this ratemaking case the Commission authorized a rate of return which it determined to be the *minimum* needed by the Company and that, in so doing, it *assumed* the continued availability of the increase in the ITC benefits provided by the Tax Reduction Act of 1975 (see Juris. Statement, pp. 9 and 10), *despite* its awareness, from the evidence before it,[5] of contrary views of the IRS as to the requirements under the federal tax laws for continued ITC eligibility (Appendix pp. 282, 296, and 301).
2. With respect to Edison's contention that it will incur irreparable damage, if its experience proves similar to that of the other California utilities[6] and it receives an adverse ruling as

[4]Question "2. Whether a state regulatory commission, which has ordered utility rates designed to produce only the minimum revenue (return) required by law and which, in so doing, has arbitrarily and unjustly disregarded certain costs and assumed, contrary to existing federal precedential rulings, the existence of a tax credit (without which the rates would produce less than the minimum return required by law), has violated the rights of the utility and its shareholders under the federal constitution by depriving them of property without due process of law and by denying an opportunity to earn a reasonable return. (U.S. Const. amend. XIV.)" (See pp. 5 and 6 of Jurisdictional Statement.)

[5]Ex. 125, Appendix p. 282; Ex. 126, Appendix p. 296; Ex. 127, Appendix p. 301.

[6]As pointed out in the Jurisdictional Statement, since the close of the record in this case, we are advised that adverse rulings have been issued by the IRS in four more rulings involving California telephone utilities (two relating to ITC and two to accelerated depreciation (see Docket Nos. 78-606 and 78-607, App. D, pp. 95A and 116A and App. 3, p. 133a)).

to the continued eligibility in response to its request to the IRS, Appellees assert that such claim is premature (Motion p. 6). Such assertion is specious and reflective of the unlawful arbitrary actions of the Commission and should be taken with a grain of salt in view of the following:

(a) Appellees do not deny that loss of the tax credits which would result would effectively deny Edison any opportunity to earn, from the rates authorized, the return determined by the Commission to be the minimum required, and that such loss could not be utilized to support a later claim, in a subsequent rate proceeding, that rates for the future were confiscatory (see p. 22 of Jurisdictional Statement and cases cited therein).

(b) The Commission has not sought any determination from the IRS as to whether its ratemaking treatment meets federal requirements for continued eligibility, and it has declined to join in any such request by others.

(c) The Commission has refused to provide interim safeguards pending an IRS ruling.

(d) The Commission is well aware that, in the absence of a ruling by this Court in this case, the ultimate determination will be made subsequent to the tax audits by the IRS in later proceedings, in which the Commission could not be required to be a party, and that Appellant, if such tax credits are disallowed, would be compelled

to pay out substantial sums which it could not thereafter recover from its ratepayers.

(e) The Commission is well aware that once its Decision becomes a "final determination" within the meaning of the Internal Revenue Code, any curative action by the Commission would be foreclosed with respect to years to which the commission decision applied under the provisions of Internal Revenue Code Section 46(f)(4).

(f) The Commission is well aware of the existence of conflicting views between the IRS and the Commission as to what rate actions may be taken by it under the federal tax laws without jeopardizing eligibility for ITC benefits, and, by its aforesaid actions and Decisions from which this appeal is taken, the Commission has arbitrarily and unlawfully put Appellant in a position of substantial jeopardy. (*Cf. New England Telephone & Telegraph Company v. P.U.C.*, June 28, 1978, CCH Utilities Law Reports-State 7-31-78, Par. 22596.03 cited p. 23, Jurisdictional Statement.)

Under the circumstances, it is respectfully submitted, the Commission's actions, placing the utility in such jeopardy, are manifestly "an exercise of arbitrary power at variance with 'the rudiments of fair play' . . . long known to our law." *West Ohio Gas Co. v. Public Utilities Commission of Ohio* (1935) 294 U.S. 63, 71.

3. The Commission appears to confuse Edison's contention that, under the decisions of this Court, the United States Constitution requires

that rates be fixed to afford it the *opportunity* to earn a non-confiscatory return,[7] with a claim which Edison does *not* make, *i.e.*, that its rates must be set so as to insure or guarantee it a specified return (see Motion p. 9).

(a) It is, we submit, manifestly clear that where the Commission recognized that the record indicated that a return on common equity of at least 13.28% would be required to raise market price to book value, the allowance of only 12.63% denies it the *opportunity* to earn a fair return[8] which would avoid dilution of the existing ownership interests of present shareholders in the enterprise. *Cf. New England Telephone & Telegraph Co. v. Department of Public Utilities*, 354 N.E.2d 860, 16 PUR 4th 346 (Mass. 1976) cited at pp. 14 and 15 of Jurisdictional Statement.[9]

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[7]Such distinction has long been recognized by this Court; as stated by Mr. Justice Brandeis: "The thing devoted by the investor to public use is . . . capital embarked in the enterprise. Upon the capital so invested the Federal Constitution guarantees to the utility the opportunity to earn a fair return." See: *Missouri ex rel. SW Bell T. Co. v. Public Service Comm.* (1922) 262 U.S. 276, 290; 67 L.ed 981, 986. *Federal Power Commission v. Natural Gas Pipeline Co.*, (1942) 315 U.S. 575, 590; *Smyth v. Ames*, 169 U.S. 467, 544-5; *Bluefield W.W. & Improv. Co. v. Pub. Serv. Comm.*, (1923) 262 U.S. 679, 692-4; *FPC v. Hope Natural Gas Co.*, (1944) 320 U.S. 591, 602-4. Also see *New England Tel. & Tel. Co. v. Mass. Dept. of Pub. Util.* (1976) 354 N.E. 2d 860, 864; 16 PUR 4th 346, 349-50.

[8]See Decision No. 86794, pp. 20 and 23; Appendix pp. 19 and 21.

[9]In their Motion Appellees assert that the Supreme Judicial Court of Massachusetts in the *New England Telephone* case is inconsistent with the *Hope* case and "gave no authority

(This footnote is continued on next page)

(b) It is, we submit, equally clear that when increased rates, fixed on the basis of a test year cost of service, including the minimum required return, are not made effective until the end of such year, with no adjustment for such delay, the utility is denied any *opportunity* to earn a fair return, and such a rate order deprives the utility of its property without due process of law in violation of the XIV Amendment to the U.S. Constitution.

Conclusion.

Considering the importance of the establishment of uniform interpretations of the federal tax laws and the magnitude of the amounts in jeopardy, as well as the equities of the matter and the constitutional rights involved in the fixing of just and reasonable utility rates, we respectfully submit that the conflicting views of the IRS and the state regulatory commission concerning the proper interpretation of the federal tax laws creates as significant a need for the exercise by this Court of its jurisdiction to review the matter as would a conflict between two federal circuit courts on such important matters. A decision having such far reaching impact as this case upon regulated public

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other than its own decision in support of its holding" (Motion p. 9). This is something of a retreat from their assertion before the California Supreme Court that such *New England* decision "does not even make a pretense of following the *Hope* and *Bluefield* decisions" (Appendix p. 237). The response made at that time is equally applicable here: "While it is true that the Massachusetts Supreme Court in that decision cited only the Massachusetts Supreme Court cases, a number of those other Massachusetts cases did cite the *Hope* and *Bluefield* decisions and applied the ratemaking principles established by them." (Appendix pp. 237 and 238 and footnote 1).

utilities—a vital sector of the Nation's economy—calls for review by this Court. We urge the Court to exercise its jurisdiction to review this case.

Respectfully submitted,

JOHN R. BURY,
WILLIAM E. MARX,
ROLLIN E. WOODBURY,
Attorneys for Appellant
Southern California Edison Company.